No. 20,771

United States Court of Appeals

For the Ninth Circuit

Sayre & Company, Ltd.,
Appellant,

vs.

A. G. Maddox, Commissioner of Revenue and Taxation,
Appellee.

Appellant's Opening Brief

On Appeal from the District Court of Guam

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No. 20,771

United States Court of Appeals

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SAYRE & COMPANY, LTD., *Appellant,* vs. A. G. MADDOX, Commissioner of Revenue and Taxation, *Appellee.*	}

Appellant's Opening Brief

On Appeal from the District Court of Guam

JURISDICTIONAL STATEMENT

The jurisdiction of this action is vested in the District Court of Guam by Section 22(a), Organic Act of Guam, 72 Stat. 178 (1958), 48 U.S.C., Section 1424(a), and Guam Code of Civil Procedure, Section 82, in that the amount in controversy exceeds $2,000, exclusive of interest and costs. This Court has jurisdiction of this appeal; 28 U.S.C., Sections 41, 1291 and 1294(4).

STATEMENT OF FACTS

Appellant is a corporation organized in 1948 under the laws of the State of Hawaii with its principal office in Honolulu, Hawaii. Prior to 1955 appellant, a corporation,

actively engaged in selling household appliances in Hawaii under several exclusive franchise agreements. Appellant at no time operated as a business on Guam and has never conducted a retail sales program on Guam.

In 1954 John L. Sayre, president and controlling shareholder in Sayre and Company, Ltd., moved to Guam and opened a retail sales establishment as a sole proprietorship which did business as the Kirby Company. The appealing corporation made loans and advances to the Guam business to supplement Mr. Sayre's personal investments. The funds advanced to Mr. Sayre were carried on open account on the books of appellant bearing interest at 5% on the average, unpaid balances.

Appellant is the owner of several distributorship franchises for household appliances for the Pacific area which includes Hawaii and Guam. These franchises are exclusive and prohibit sales by other companies in the territory governed by appellant's agreement. Speed Queen washers and dryers, Kirby vacuum cleaners, and Amana freezers are among the named brand appliances covered by such agreements. These exclusive franchises are valuable property rights of the appellant.

Sayre & Company, Ltd. (hereinafter called Sayre) charged the Kirby Company (hereinafter called Kirby) the normal distributor commission on all products purchased under the exclusive franchise agreements. *R.T. 22. These commissions were not in excess of the amounts which would be obtained in a normal distributor-dealer relation. R.T. 22. At all times the separate entities of Sayre and Kirby were maintained.

The merchandise, upon which commissions were charged, was ordered directly by Kirby on Guam who took title to

*R.T. refers to Reporter's Transcript.

the merchandise and assumed risks of loss, F.O.B. factory, mainland United States. R.T. 23.

The amounts due to appellant from Kirby were used to defray the costs incurred in maintaining the Hawaiian corporation. The Hawaiian corporation continued to have costs in maintaining the various exclusive franchises. R.T. 24.

Sayre and Kirby maintained separate financial books and records during the entire period in question. Both companies used the accrual system of accounting; each reports income as the right to receipt occurs. During the tax years in question, 1955, 1956 and 1957, Sayre reported as income the amount of interest and commissions which had accrued to the United States Department of Internal Revenue and paid the applicable federal taxes. For each of these years, the federal government examined the returns and allowed certain business deductions claimed by appellant. R.T., Schedules 26, 27, 29 and 30.

On April 1, 1965, the appellee advised the appellant of deficiencies for tax years 1955, 1956, and 1957 in the total amount of $6,137.04 representing the tax calculated upon commissions and interest paid to the Hawaiian corporation. This action for redetermination of Guam territorial income tax was brought on August 30, 1965.

The government of Guam contended in the trial court that the amount received by the Hawaiian corporation was taxable under section 881 of the Internal Revenue Code, Title 26, made applicable to Guam by 48 U.S.C. § 1421. Section 881 of the Internal Revenue Code provides that a "foreign" corporation which is not engaged in trade or business within the United States (Guam) is taxed at the rate of 30% of the amounts received, from sources within the United States (Guam). At all times herein the government of Guam has contended that appellant is a foreign

corporation which is not engaged in business on Guam but receives income, interest and commissions from a Guam company and therefore taxable at the 30% gross income rate provided in § 881. Under § 881 no deduction for business expenses is allowed.

The trial court held that appellant was taxable under § 881 at the rate of 30% of gross income received from Guam and was not allowed any business deductions. Concluding that any person or corporation that received income from Guam must pay the Guam territorial income tax, the trial court upheld the assessment and gave judgment for the government in the amount of $6,137.

ISSUES PRESENTED

The issues presented by this appeal are as follows:

I. Can Guam's Internal Revenue Code Be Given Extraterritorial Application to Tax the Intangibles of a Hawaiian Corporation?

II. May Guam Impose a Burden of Taxation More Onerous Than a State or the United States; Did the Trial Court Err in Characterizing Appellant as a Foreign Corporation?

III. Can the Internal Revenue Code, as Applied in Guam, Be Interpreted to Impose Taxes Which Discriminate Against Interstate Commerce and Deny Due Process of Law?

SUMMARY OF ARGUMENT

Congress, in enacting the Organic Act of Guam, 48 U.S.C. § 1421 et seq., did not intend to allow Guam to give its tax laws extra-territorial application. In the instant case the government of Guam is attempting to tax a Hawaiian corporation which is not engaged in business on Guam. It is axiomatic that states do not possess such power; it is inconceivable that Congress intended Guam to have such authority.

The Organic Act expressly recognized that certain sections of the Internal Revenue Code could not be made

applicable to Guam. Consistent with this understanding § 1421i(d)(1) provides that the code was to apply except where "manifestly inapplicable or incompatible." Incontrovertibly the intent of Congress was to create a territorial income tax and the tax was so denominated. 48 U.S.C. § 1421i(b). This denomination recognizes the inherent territorial limitation of the tax to residents of Guam and those who do business within the territorial limits of Guam. Obviously the proper interpretation of the statute forecloses a tax upon foreign corporations who only receive income from Guam.

The revenue provision contested in the instant case is within "Subchapter N—TAX BASED ON INCOME FROM SOURCES WITHIN OR WITHOUT THE UNITED STATES, Part II. Nonresident aliens and foreign corporations." (§ 881. Tax on foreign corporations not engaged in business in United States.) The language of this section purports to tax *all* corporations whether within the territory or not. While such authority is within the powers of the federal government it cannot lightly be implied as given to Guam. Such a broad grant of power was not intended. Guam's territorial income tax is limited in application to objects of taxation within the jurisdiction of the Government of Guam.

Assuming *arguendo* that § 881 is not manifestly inapplicable, by definition, appellant cannot be considered within its terms. Internal Revenue Code § 7701, "Definitions", defines a domestic corporation to include a corporation which is organized under the laws of any State. Therefore, the proper construction of § 881 in Subchapter N precludes its application to a Hawaiian corporation, since by definition it is domestic.

Indisputably taxation of a Hawaiian corporation at a higher rate than a domestic corporation denies due process

of law guaranteed by the United States Constitution. A tax which penalizes a Hawaiian corporation by not allowing legitimate business deductions and imposes a flat 30% tax rate obviously unjustifiably discriminates against that corporation. No state has such power and a congressional intent to contravene the Constitution should never be implied.

Interest and commissions are presumptively taxable at the situs of the corporation and not elsewhere under the *mobilia sequunter personam* rule. Intangibles, debts and choses in action, have a taxable situs only at the owners domicile and only the domicilary state can tax the income from the intangibles. The government has clearly admitted that appellant does not do business on Guam. Therefore, the intangibles are only taxable by Hawaii since Guam does not provide any of the benefits of government, to this corporation, which is the basis for the imposition of taxes by all governments.

ARGUMENT

I. Can Guam's Internal Revenue Code Be Given Extraterritorial Application to Tax the Intangibles of a Hawaiian Corporation?

While state revenue laws may be applied to tax all property, persons and corporations within the state, the state cannot give those laws extraterritorial application. *Frick* v. *Pennsylvania*, 268 U.S. 473, 69 L.Ed. 1058(1925); *Union Refrigerator Transit Co.* v. *Kentucky*, 188 U.S. 385, 47 L.Ed. 513(1903); *James* v. *Dravo Contracting Co.*, 302 U.S. 134, 82 L.Ed. 155(1937). The tax which the government of Guam attempted to impose herein is upon a corporation which is "not engaged in trade or business within Guam." 26 U.S.C. § 881—substituting "Guam" for "United States" as provided by 48 U.S.C. § 1421i(e). The government of Guam admits that it cannot tax the corporation under any other section of

the Internal Revenue Code, R.T. 14, as appellant does not engage in business within the territory.

This rule, precluding extraterritorial application of tax laws, is universally recognized. "As a general rule taxes may be imposed on, and only on a foreign corporation which is carrying on business within a state." 84 C.J.S., Taxation, § 188, 51 Am.Jur., Taxation, § 58. The legislative history of the Guam income tax law supports the conclusion that the intent of Congress was to allow a tax which was limited to residents and those doing business on Guam. The following testimony, during the debate, clearly indicates this limitation:

> Mr. PETERSON. Our colleague the gentleman from Nebraska [Mr. MILLER] has made a study of that. The amendment he offered and which we have adopted today will be very helpful in that respect.
>
> Mr. MILLER, of Nebraska. There will be no direct payment by the Treasury of this country. The amendment we just adopted in committee provides that the income tax laws in force in the United States of America and which may hereafter be in force will be the law over there. That will be of great help in plugging certain loopholes. The people of Guam and a large number of civilians and workers over there on construction work, as well as military personnel, pay no income tax or have no withholding tax. In fact, they are paid a bonus for working there. This will plug that loophole and bring in some money to the United States Treasury. As I understand it, the salaries of these people will be paid by the Guamanian Government and the average deposit in Guamanian banks of the people of Guam averages about $8,000.00.
>
> Mr. SCRIVNER. In other words, I am to understand that there is sufficient property, there are sufficient sources of revenue right there on the island of Guam so that they will be able to set up a tax structure suffi-

> cient to carry their own expenses of government without asking for any contribution from the United States to help carry their government cost?
>
> Mr. MILLER, of Nebraska. That is my understanding.
>
> Mr. PETERSON. That is my understanding also. 96 Cong. Rec. May 23, 1950, at page 7577.

Recognizing the territorial limits of the taxing authority conferred will give effect to the purpose of Congress which is the dominent factor in construing the statute. *U.S.* v. *C.I.O.,* 355 U.S. 106, 92 L.Ed. 1849(1948). Characterization of the tax as a Guam territorial income tax recognizes the limits expressly imposed upon the government of Guam. Residency limitations were recognized by the United States Revenue Service in Revenue Ruling 8, 1953-1 CB 300:

> A citizen of the United States *who is a resident of Guam* is liable to Guam for tax on his income from whatever source derived, . . . (emphasis added).

The Guam Internal Revenue Code was an adaptation from the Virgin Islands Law. *Holbrook* v. *Taitano,* 125 F.Supp. 14 (D.C. Guam 1954). Committee Report, U.S. Code Cong. and Ad. News, 1958, Vol. 2, page 3651. In I.T. 2946 XIV-Z CB 109, cited by the Congressional Committee with approval, the United States Commissioner interpreted the Virgin Islands Internal Revenue Act as applying to all citizens who have a *residence* there. The statute should be construed as a whole to give effect to the dominent purpose of Congress. *U.S.* v. *Alpers,* 338 U.S. 680, 94 L.Ed. 457(1950); *Worchester Felt Pad Corp.* v. *Tucson Airport Auth.,* 233 F.2d 44 (9th Cir. 1956). Congressional intention should be deduced from the statute as a whole. *Korte* v. *U.S.,* 260 F.2d

633 (9th Cir. 1959) cert. denied 358 U.S. 928, 3 L.Ed.2d 301 (1959).

Construed as a whole Subchapter N, Part II, of the Internal Revenue Code was meant to be applied by the United States but not by Guam. Protracted analysis is not required to see the inapplicability of the whole section. The title, "Nonresident Aliens and Foreign Corporations", alone indicates the inapplicability. Section 871—"Taxation of nonresident alien individuals, and section 891—Doubling of rates of tax on citizens and corporations of certain foreign countries", patently cannot be applied by Guam. Construction of this statute to prevent inconsistencies requires a determination that this Subchapter is manifestly inapplicable to Guam. This manifest inapplicability cannot be cured by a simple substitution of terms. An attempted extraterritorial application of the Guam territorial income tax law clearly contravenes the intent of Congress and the limitations inherent in the Territories' right to tax. Section 881 purports to tax all amounts received from sources within the United States for any reason. If applied as contended by appellee every company or individual who sold products to any one residing on Guam would be required to pay Guam income tax on such sales. Such a conclusion is unwarranted in the absence of specific Congressional authorization.

Constitutional principles arising from the due process clause of the 14th Amendment and the equal protection clause of the Constitution also dictate against the extraterritorial application of the Guam territorial tax. *McCulloch* v. *Maryland,* 4 Wheat 316, 4 L.Ed. 579 (1819) at 607. Unbroken precedent prescribes such construction. *Safe Deposit & T. Co.* v. *Maryland,* 280 U.S. 83, 74 L.Ed. 180(1929); *Frick* v. *Pennsylvania,* 268 U.S. 473, 69 L.Ed. 1058(1925). Absence

of benefits to the property prescribes taxation. *Wisconsin* v. *J.C. Penney Co.,* 311 U.S. 435, 85 L.Ed. 267(1941).

Factually it is undisputed that appellant did not engage in business on Guam. Appellant's right to the receipt of interest and commission income, from the loans and franchises, represents intangible personal property. The tax as assessed is upon this intangible personal property. Jurisdiction to tax intangibles can only occur in the corporation's domiciliary state. 84 C.J.S. Taxation, § 116; *Curry* v. *McCanless,* 307 U.S. 357, 83 L.Ed. 1339(1939) at 366; *First Bank Stock Corp.* v. *Minnesota,* 301 U.S. 234, 81 L.Ed. 1061 (1937) at 241; *Graves* v. *Schmidlapp,* 315 U.S. 657, 86 L.Ed. 1097(1941). This rule, *mobilia sequuntur personam,* exempts intangible property from taxes except at the domicile of the owner.

> In cases where the owner of intangibles confines his activity to the place of his domicile it has been found convenient to substitute a rule for a reason, cf. New York el rel. *Cohn* v. *Graves,* 300 U.S. 308, 313, 81 L.Ed. 666, 670, 57 S.Ct. 466, 108 A.L.R. 721; *First Bank Stock Corp.* v. *Minnesota,* 301 U.S. 234, 241, 81 L.Ed. 1061, 1065, 57 S.Ct. 677, 113 A.L.R. 228, by saying that his intangibles are taxed at their situs and not elsewhere, or perhaps less artificially, by invoking the maxim *mobilia sequuntur personam, Blodgett* v. *Silberman,* 277 U.S. 1, 72 L.Ed. 749, 48 S.Ct. 410, supra; *Baldwin* v. *Missouri,* 281 U.S. 586, 74 L.Ed. 1056, 50 S.Ct. 436, 72 A.L.R. 1303, supra, which means only that it is the identity or association of intangibles with the person of their owner at his domicile which gives jurisdiction to tax.

This rule has won unqualified acceptance. *First Bank Stock Corp.* v. *Minnesota,* 301 U.S. 234, 81 L.Ed. 1061(1937) at 241. The *mobilia sequuntur personam* rule therefore prohibits the application of a Guam tax upon the intangibles of a Hawaiian corporation.

II. May Guam Impose a Burden of Taxation More Onerous Than a State or the United States; Did the Trial Court Err in Characterizing Appellant as a Foreign Corporation?

Appellant reported the income in question to the United States in each of the years in question. In each year returns from the corporation were audited by the United States Internal Revenue Service. The United States made minor adjustments in the return but allowed the majority of the deductions claimed. The trial court did not allow any deductions for the years in question thus imposing a greater tax burden upon the appellant than that of the federal government.

The legitimacy of these deductions, as allowed by the federal government, is undisputed. An assessment by appellee which exceeds that which the federal government would make is doubtful. *Koster* v. *Government of Guam,* No. 20438, decided June 8, 1966 (9th Cir. 1966).

Since a corporation, incorporated under the laws of Hawaii, was denied any legitimate business deductions by the trial court, this ruling places a corporation organized under the laws of another state at a competitive disadvantage. This is not allowable under the prevailing and persuasive legal authority. *Wheeling Steel Corp.* v. *Glander,* 337 U.S. 562, 93 L.Ed. 1544(1949).

Assuming, *arguendo,* that the corporation was taxable it cannot be taxed as a "foreign" corporation under the internal revenue code. The code provides definitions in § 7701 applicable to § 881. R.T. 14. Domestic and foreign corporations are defined in § 7701 as follows:

> (4) The term "domestic" when applied to a corporation or partnership means created or organized in the United States or under the laws of the United States or of any State or Territory.

(5) Foreign.—The term "foreign" when applied to a corporation or partnership means a corporation or partnership which is not domestic.

Under these definitions the appellant, organized under the laws of the state of Hawaii, is a domestic corporation and by admittance of the defendant not taxable by the Government of Guam.

No doubt can exist that § 7701 applies to Guam under the relevant portion of Organic Act of Guam. 48 U.S.C. 1421 (d)(1). This provision of the code is applicable to Guam since it is not manifestly or otherwise inapplicable. *Koster* v. *Government of Guam,* No. 20438, decided June 8, 1966, (9th Cir. 1966).

III. Can the Internal Revenue Code, as Applied in Guam, Be Interpreted to Impose Taxes Which Discriminate Against Interstate Commerce and Deny Due Process of Law?

Under the due process clause of the Constitution, a state cannot impose a tax unless certain minimum contacts or a nexus with the taxing state is established. *International Shoe* v. *Washington,* 326 U.S. 310, 90 L.Ed. 95(1945). The contacts with the taxing state must be of such quality to make it reasonable, in the context of the federal system, to allow the jurisdiction to tax. Under this standard the tax as imposed by Guam denies due process of law since the tax is imposed upon a nonresident corporation which has no contacts with Guam other than the receipt of income. Secondly the tax imposed, 30% without legitimate business deductions, unduly burdens interstate commerce. Not a single direct impediment on interstate commerce is allowed to a state. *Gibbons* v. *Ogden,* 9 Wheat 1, 6 L.Ed. 23(1824); *Portland Cement Co.* v. *Minnesota,* 358 U.S. 450, 3 L.Ed. 2d 421 (1959). A state cannot tax those who do not come

into the state or impose a tax on the privilege of engaging in interstate commerce. *Spector Motor Service, Inc.* v. *O'Connor,* 340 U.S. 602, 95 L.Ed. 573 (1951). Nor can a state impose a tax burden which prefers local business to interstate business. *Nippert* v. *Richmond*, 327 U.S. 416, 90 L.Ed. 760 (1946); *Freeman* v. *Hewitt,* 329 U.S. 249, 91 L.Ed. 265 (1946).

From the foregoing analysis it is obvious that section 881 was never intended to be applied by the government of Guam. Courts should never construe a statute to give it an unconstitutional application. *U.S.* v. *Witkovich,* 353 U.S. 194, 1 L.Ed.2d 765(1957); *Driscoll* v. *Edison Light and Power Co.,* 307 U.S. 104, 83 L.Ed. 1134(1957). The proper construction of the Internal Revenue Code, which should be construed as a whole, supra, is to limit its application to persons, objects and corporations within the jurisdiction. In construing this statute it must be presumed that Congress was aware of the established judicial decisions and limits imposed by the interstate commerce clause and the due process clause of the Constitution. In the absence of compelling evidence to the contrary the construction of the Organic Act should consider these decisions as limits which Congress considered unabrogated by the passage of that act.

CONCLUSION

Reversal of the decision of the District Court of Guam will affirm an unbroken line of judicial authority prohibiting extraterritorial application of state and territorial revenue laws. In the absence of express Congressional intention such a violent departure from established precedent should not be implied. Taxation of the intangible personal property of nonresidents in contravention of the commerce and due process clauses of the Constitution was never intended

by Congress. By definition appellant is not within the purview of the Internal Revenue section relied upon by appellee. Affirmation of the court's decision would give Guam the extraordinary power to tax any business which sold products to a resident of Guam. The decision of the District Court allows Guam to assess taxes which are arbitrary, discriminatory, and unreasonable since all legitimate business deductions are disallowed.

Therefore, appellant respectfully urge that the United States Court of Appeals for the Ninth Circuit reverse the decision of the District Court of Guam and remand this action to that court for further proceedings consistent therewith.

Dated at Agana, Guam 10 August 1966.

Respectfully submitted,

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CERTIFICATE

I certify that in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

David S. Madis
Attorney for Appellant